UNITED STATES DEPARTMENT OF AGRICULTURE
Agricultural Marketing Service
(Dairy Programs)

Milk in the Central Marketing Area	)	
	)	**Dkt AO 313-A44**
Hearing on Proposals to Limit Pooling of Out-of-Region Milk	)	**DA 01-07**

COMMENTS AND EXCEPTIONS TO TENTATIVE DECISION OF THE SECRETARY ON BEHALF OF: FOREMOST FARMS, LAND O'LAKES, FIRST DISTRICT ASS'N, FAMILY DAIRIES USA, MIDWEST DAIRYMEN'S COOP., MANITOWAC MILK PRODUCERS COOPERATIVE, ASSOCIATED MILK PRODUCERS, AND MILWAUKEE COOPERTATIVE MILK PRODUCERS (HERINAFTER "THE COOPERATIVES")

I. INTRODUCTION: CONFLICTS IN PAST AND PRESENT AGENCY POLICY.

The Tentative Final Decision of the Secretary ("decision"), published at 67 Fed. Reg. 69910 (Nov. 19, 2002), reflects a sea change in federal milk marketing order policy. Following the lead of the nation's most influential dairy cooperative, the Central Market decision, without study of historical blueprints of the dairy program's architects, dismantles a cornerstone of the structure – the desirability of pool participation for surplus milk and producers of Grade A milk who do not have ready access to share of the fluid market. The decision seeks to cull from

participation in the order's revenue pool producers who are ready, willing and able to serve the market, but whose milk is frequently not needed because the region's dominant suppliers have effectively cornered the market for raw Class I milk and the associated asset of pool access. The Secretary's decision to eliminate "have-not" dairy farmers from the pool is aggravated by recent consolidation of large distributor and dairy cooperatives, leaving smaller cooperatives and independent producers to scramble for pool participation through fewer buyers with very limited uncommitted Class I capacity, or (more likely) to find themselves without access to the Order 32 pool.[1]

The 'grandfather' of court decisions describing the need for government intervention is the U.S. Supreme Court case of *Nebbia v. New York*, 291 U.S. 502 (1934) which described the "milk problem" at pp. 517-518 as follows:

[1] Class I marketing opportunities for smaller cooperatives and independent producers were further reduced, and dramatically so, as of January 1 of this year, by the new Dean Foods and DFA alliance under which Dean Foods ceased operations as a pooling handler, releasing its procurement functions to DFA and affiliated DMS (Dairy Marketing Services) cooperatives. *See* Cheese Market News, "Dean Foods is using DMS to manage independent milk" (Jan. 17, 2003); Letter of January 7, 2003, from Richard Lentz, Director of Milk Procurement, Dean Foods ("Effective January 2003, Dean Foods will be outsourcing its milk procurement functions to Dairy Marketing Services."). This event is, obviously, not "of record" in the Central Market rulemaking proceeding, but is such a significant development that the integrity of the November 2001 record as a reflection of current marketing conditions is in serious question. For this reason, among others, the hearing should therefore be reopened. Tthe Secretary should also undertake a thorough investigation of "whether or not there has been any abuse of the privilege of exemptions from the antitrust laws" (7 U.S.C. § 608d), employing the incorporated tools of investigation under the Federal Trade Commission Act (7 U.S.C. § 610(h)).

> Close adjustment of supply to demand is hindered by several factors difficult to control. Thus surplus milk presents a serious problem, as the prices which can be realized for it for other uses are much less than those obtainable for milk sold for consumption in fluid form or as cream. A satisfactory stabilization of prices for fluid milk requires that the burden of surplus milk be shared equally by all producers and all distributors in the milk shed. So long as the surplus burden is unequally distributed the pressure to market surplus milk in fluid form will be a serious disturbing factor.

A similar explanation of the need for government intervention was made in the *Rock Royal* case four years later, the first federal milk order issue decided by the Supreme Court.

The 1962 "Nourse Report" (Report of the Federal Milk Order Study Committee to the Secretary of Agriculture) also addressed the need to accommodate all reasonably available milk supplies on policy and economic grounds. While noting that large surplus milk supplies could present problems, the report cautioned (at p. 67) that "the only alternative for such supplies may be the *even more disruptive status of milk without a market or at least without a share of a Class I outlet*." The "Nourse Report," as it became known after Committee Chairman, Dr. Edwin Nourse, has been cited as authoritative by the Secretary (*e.g.*, *In re: Borden, Inc.,* 46 Agric. Dec. 1315, 1410-1420 (1987), *aff'd, sub. nom, reported at* __ Agric. Dec. ____(N.D. Tex., __), by the United States Court of Appeals for the District of Columbia Circuit (*Schepps Dairy, Inc., v. Bergland,* 628

F.2d 11 n. 85 (D.C. Cir., 1979), and by the United States Supreme Court (*Zuber v. Allen,* 396 U.S. 168, 190-91 nn. 26 & 27 (1969)).[2]

Consistent with early judicial decisions, with economic analysis, and with principals of efficiency and equity in milk marketing rules, USDA's prior generation of regulators consistently resisted overt efforts of dominant cooperatives to structure pooling performance requirements to exclude or discourage available milk from participating in a market's pool due to its use in Class III where the market's Class I needs are being met. There are many examples of application of this policy. Some are as follows:

> "To share in the pool proceed of the order, supply plants must demonstrate the *ability* to furnish market fluid needs by shipping milk to pool distributing plants…. Shipments should not be encouraged to a greater degree than necessary to satisfy fluid milk needs…. To do so results in uneconomic movements of milk to distributing plants solely for pooling purposes rather than to meet fluid milk needs. 43 Fed. Reg. 12695, 12699 (March 27, 1978)(New England decision).
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> "The existence of pool manufacturing plants should not be a basis for narrowly limiting the amount of milk which may be diverted to nonpool manufacturing plants, since it would continue to encourage inefficient milk handling by producer groups that use nonpool manufacturing plant outlets." 46 Fed. Reg. 55876, 55888 (Nov. 12, 1981)(New England decision).

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[2] *See also:* Alden C. Manchester and Don P. Blayney. Market and Trade Economics Division, Economic Research Service, U.S.D.A., Milk Pricing in the United States (Agriculture Information Bulletin No. 761, Feb. 2001) (http://www.ers.usda.gov/publications/) at 4 (hereinafter, "Manchester, Milk Pricing"); *Zuber v. Allen*, 396 U.S. 168 (1969); Dairy Division, Agricultural Marketing Service, Questions and Answers on Federal Milk Marketing Orders, (AMS-559, Revised March 1996) ("Q & A") at 1-2 (*reproduced at* http://cpdmp.cornell.edu/ (publications).

> One day's production of a producer delivered to a pool plant during fall months is "sufficient to demonstrate that a producer has *some association* with the fluid market" 44 Fed. Reg. 64087, 64091 (Nov. 6, 1979)(Inland Empire decision).

The "some association" policy reflected in decisions described above, particularly for markets such as the Central Marketing Area with adequate supplies of milk for Class I use, is also addressed in USDA's program brochure, THE FEDERAL MILK MARKETING ORDER PROGRAM. The FMMO Program explains (at pp. 5 and 10) that FMMO's facilitate orderly marketing by providing for "the sharing among producers of the returns from all milk uses." Further, "there has been a general lessening of pooling requirements to facilitate the efficient pooling of additional supplies of Grade A milk." *Id.*

The decision, in almost every respect, severely constrains the volume of milk that may be pooled in the Central Marketing Order by limiting pooling to those producer organizations that already have control of much of the market's Class I milk supply – DFA, Prairie Farms, and Swiss Valley Farms – by dedicated Class I milk supplies, full supply contracts, or similar control of Class I market share (see fn 1, *supra*). Reasonable, performance-oriented pooling provisions, related to the market's needs, should be based not on committed and controlled supplies, but rather on remaining Class I needs in relation to milk production *after*

these committed supplies have been accounted for.[3] As adopted, the Secretary's tentative decision will not only fulfill DFA's objective of eliminating much "out-of-area" (and non-DFA) milk from the pool, but will also fail to accommodate available Grade A milk produced within the marketing area.

II. NET SHIPMENTS.

One way of demonstrating availability of milk to the market and accommodating all available Grade A milk, even if it is not needed, is to deliver milk to a distributing plant and transfer unneeded milk back for manufacturing. The decision unreasonable eliminates this opportunity. We agree that delivery in such circumstances is inefficient. The solution should be to relax performance requirements, not boot milk off the market that can only be pooled in this manner as the Secretary has done by amendments to sections 1032.7(c)(5) and 13(d)(3) of the Order.

III. OUT-OF-AREA SUPPLY PLANTS.

The Secretary's decision to create special marketing and pooling burdens for supply plants located outside of the marketing area (Sec.1032.7(c)(2) cannot be reconciled with past policy or trade barrier prohibitions of the Act.

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[3] One measure of committed Class I milk, and the relative paucity of available Class I capacity for other suppliers, is revealed in Exhibit 5, Tables 15 and 16. For August 2001, less than 10% of deliveries to distributing plants were from supply plant sources. Supply plants delivered 45 million pounds of milk to distributing plants but pooled 196 million pounds of producer milk.

The marketing or pooling of milk from "distant" dairy farms in federal milk marketing areas has long been a common feature in the federal dairy program. USDA's annual statistical publication explains:

> The volume of milk that is reported as received by handlers from producers includes all such milk regardless of where it may be sold. Milk identified as that received from producers for a given market may come directly from nearby producers or from producers associated with a supply plant which, although located several hundred miles from the marketing area, is pooled on the market.

FMOS 2001 at 7; *see also*, USDA, *Federal Milk Order Market Statistics*, *1996 Annual Summary* (Statistical Bulletin No. 938, August 1997) at pp. 9-10. Such historical pooling of milk from dairy farmers and plants located distant to the marketing area is illustrated by *Farmers Union Milk Marketing Cooperative v. Yeutter*, 930 F.2d 466 (6th Cir. 1991), which describes the very *same* economic tensions between Wisconsin farmers and Mideast (Michigan) farmers for a share of the Mideast milk revenue pool that are at issue in this Central Order proceeding. *See also*, 47 Fed. Reg. 44268, 44271 (col. 2) (Oct. 7, 1982) (describing periodic pooling of a Kansas supply plant in the Texas Marketing Area); *and* USDA, *The Market Administrator's Annual Statistical Bulletin, Northeast Marketing Area, 2001* (http://www.fmmone.com) pp. 7-9, 33 (reporting distant farmers located in Utah and Idaho pooled in the Northeast Market, and the Dannon Company plant in Utah pooled as a distributing plant in the Northeast by virtue of a plurality of at

least 6 ½% of its milk receipts distributed in beverage (Class I) form in the Northeast Marketing Area (7 C.F.R. §1001.7(a))

Further, the requirement that an out-of-area supply plant receive, pump-in and pump-out milk is not only inefficient, it is damaging to milk quality. See Hahn, Tr. 521.[4] In a predecessor order, USDA decided that 50% qualification by

[4] USDA has repeatedly acknowledged this fact, but ignored it in the Central Market Decision:

Eastern Ohio: 51 Fed. Reg. 227178, 27179, 27181 ((July 30, 1986)(partial relaxing supply plant shipment and farm diversion rules to avoid "uneconomic shipments solely for … pooling, …[and to avoid reduction in] the quality of the milk because of the extra pumping and handling involved."). Southern Michigan: 46 Fed. Reg. 25626, 25632 (May 8, 1981)("Permitting supply plant operators to include as qualifying shipments producer milk diverted to pool distributing plants would promote the efficient handling of milk supplies and eliminated the hauling of producer milk to a supply plant for transfer to distributing plants solely for the purpose of helping the sully plant meet the pooling requirements."). Chicago Regional: 53 Fed. Reg. 24298, 24309 (June 28, 1988)(Eliminating limits on milk diversion "promotes the efficient handling of milk and better milk quality."); 47 Fed. Reg. 37388, 37395 (July 21, 1977)(Allowing milk to be diverted as well as transferred between plants. "This practice [of requiring transfers to maintain pool status] is obviously uneconomic, resulting in unnecessary and costly movements of milk. In addition the unnecessary pumping of milk is damaging to its quality."Oregon: 52 Fed. Reg. 43315-16 (Nov. 12, 1987)(suspension of supply plant delivery requirements were necessary to prevent "uneconomic and inefficient handling" of milk, losses of milk and butterfat, and additional "pumping [which] reduces milk quality and enhances bacterial growth."). Nebraska: 54 Fed. Reg. 15170-71 (Apr. 17, 1989)(Increasing allowable diversions because receipt and transfer of milk is "inefficient and uneconomic, [and] the additional pumping to which the milk would be subject would be detrimental to the quality of the milk."), 53 Fed. Reg. 15358 (Apr. 29, 1988), 52 Fed. Reg. 1314 (Jan. 13, 1987), 50 Fed. Reg. 35079 (Aug. 29, 1985)(all with same result and reasoning). Iowa: 53 Fed. Reg. 36235-26 (Sept. 19, 1988)(Suspension of diversion limits provides "additional economies… by eliminating milk hauling and handling, which also adversely affects milk quality."), 50 Fed. Reg. 37505 (Sept. 16, 1985)(same), 46 Fed. Reg. 8533, 8539-8543 (Jan. 27, 1981)(amending the Order to allow for some supply plant milk to be diverted directly from farms to distributing plants, because the pump-in, pump-out transfer practice "is obviously uneconomic, resulting in unnecessary and costly movements of milk. In addition, the unnecessary pumping of milk is damaging to its quality" (*id.* at 8543)). Arizona: 48 Fed. Reg. 46343, 46346 (Oct. 12, 1983)(explaining the disadvantage of supplying milk by supply plant transfers: "Rather than being moved directly from the farm to the fluid processing plant where it is needed, milk would first have to be physically received at the supply plant…. In addition to the unnecessary cost of unloading and reloading milk, and the rerouting of the current

diversion provided a balance between efficiency and potential pool loading of distant milk. 46 Fed. Reg. 8533, 8539-40 (Jan. 27, 1981)(Allowing one-half of supply plant shipments to be diverted from farms in a supply plant's normal 150-mile procurement area, but requiring the remainder to be transferred, would promote transportation efficiency and milk quality while at the same time preventing distant manufacturing plants and producers from qualifying by arrangements with "producers near the market center who had no real association with the manufacturing plant… or who are not "within a reasonable hauling distance of the supply plant."). USDA's failure to follow or distinguish this precedent renders the decision arbitrary.

III. DIVERSIONS.

The most restrictive amendment for "have-not" producers is the amendment to section 1032.13 diversion limits. By combining a net shipments provision with a novel limitation allowing diversions *only* on the volume of milk delivered to Class I distributing plants, rather than milk received by any pool plant, the Secretary has carefully excised substantial milk that does not have a share of committed Class I market supplies from the pool. The higher blend price accruing

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farm to bottling plant transportation system, the quality of the milk supply would suffer from additional pumping and extension of the time between pick-up and final delivery."). Great Basin: 54 Fed. Reg. 30881-82 (July 25, 1989)(increasing diversion allowance, because receipt and transfer is "inefficient and uneconomic, [and] the additional pumping to which the milk would be subject would be detrimental to the quality of the milk.").

to producers, such as DFA, as a result of their large and committed share of the Class I market is simply "a disguised payment for the nearby suppliers' greater share of fluid milk sales" of the same nature as the rule criticized by the Supreme Court in *Zuber v. Allen*, 396 U.S. 168, 179-80 n.12 (1969), in violation of Section 8c (5) (B) (ii) of the AMAA.

CONCLUSION

For reasons stated herein, in the cooperative's opening brief and in their hearing testimony, the Tentative Decision should be suspended, and amendments adopted in a revised decision that are consistent with past agency policy. If the Secretary decides that past agency policy should not apply, his departure from policy should be squarely confronted and explained.

The proceedings, further, should be reopened for investigation and hearing to consider the significant changes in market supply and market control by events described in footnote 1, *supra.*

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Respectfully submitted,

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